

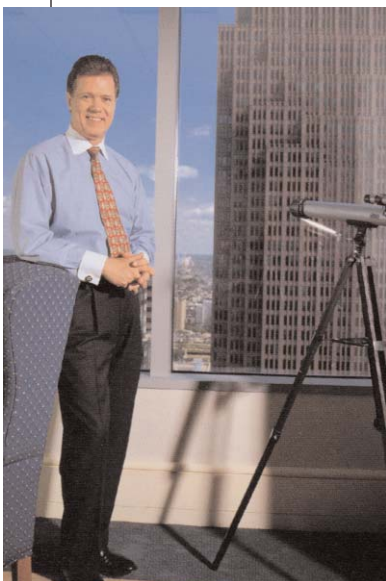


SECOND QUARTER 2006

**NOTHING HAS CHANGED**

If you have been reading these Navigator Reports you know that we have been cautious since the end of last year. We have been expecting a tough year to unfold because this year is the mid-term election year of the Presidential Election Cycle and also the fourth year of a very definitive stock market cycle. In The Navigator Report for the first quarter we said that only three bull markets had gone on longer than the current market without at least a 10% decline. Today's market is now the second longest of the past 80 years without that 10% decline. The longest bull, without at least a 10% correction, was from Oct. 1990 through May 1996 or 1420 days and returned 131.27% on the S&P 500. The current situation has gone on from the March 2003 bottom, or 815 days, and has returned 63.9%. I am quite sure it will never last to become the longest.

**There will be some great opportunities when this market finds its footing later this year.**



The problems that we mentioned many months ago are still with us. High energy costs, increasing interest rates, slowing economic growth, and slowing consumer spending have not gone away. If anything, they have become bigger problems.

Sean Clark, our Chief Investment Officer, and I, are frequent guests on CNBC

**CCMG IN THE NEWS**

July 1, 2006

**Financial Advisor**

Harry Clark, Chief Executive Officer, and Sean Clark, Chief Investment Officer, of Clark Capital Management discuss the value of using derivatives in separately managed accounts in a feature article in Financial Advisor.



June 21, 2006

**Bloomberg "Morning Call"**

Sean Clark, Chief Investment Officer at Clark Capital Management, believes that on a short term basis, the market has reached a bottom. He expects a two to three week rebound rally into mid-July before the market turns lower again.



June 12, 2006

**CNBC "On the Money"**

As investors await inflation data released from Ben Bernanke, Harry Clark, Chief Executive Officer of Clark Capital Management, says that historical evidence shows a slight recession is likely and inflation will go down.



and Bloomberg television. We are often asked to take the “bearish” side of short debates because the interviewers know that our position has been one of caution.

During the first part of this year it was difficult to find many analysts who were not raging bulls. The market seemed to be enjoying success and was approaching the all-time highs achieved at the top of the last bull market in 2000. But stock markets do not only go up, corrections are inevitable and healthy. We have also been very careful to say how bullish we are about the period following the correction that lies ahead. So we remain cautious for now, but very bullish for later once the correction gets out of the way.

## IT'S DIFFERENT THIS TIME!

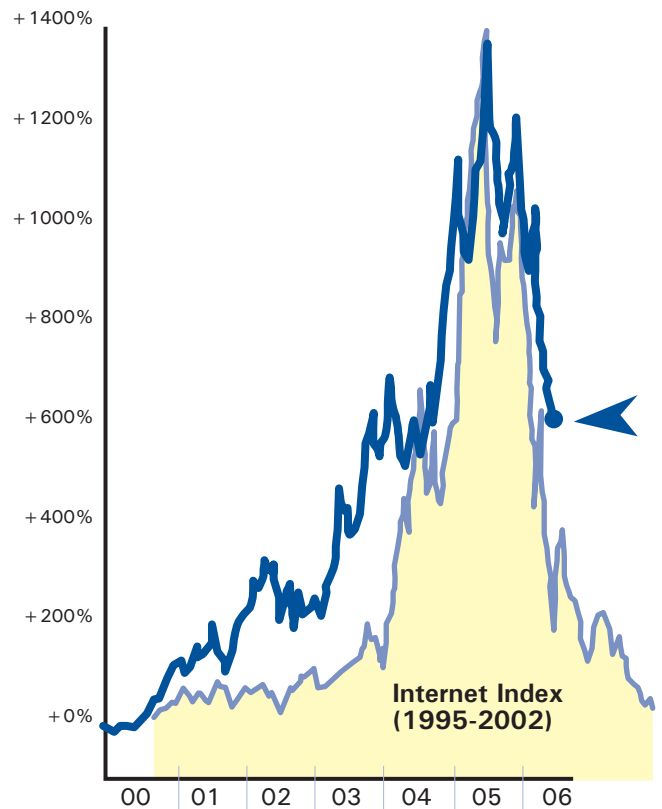
This old Wall Street adage has cost investors serious losses over the years because things rarely turn out to be different. What causes this phenomenon is investor optimism and the feeling that profits are just around the corner; hence, it must be different this time.

The Federal Reserve and the Chairman of the Fed, now Mr. Bernacke, are charged with keeping the U.S. economy growing, keeping unemployment low, and controlling inflation. Of these tasks, it is believed that controlling inflation is job number one. That might seem strange because to do that task there are times when the Fed has to reign in the economy by raising interest rates. And raise rates they do, even to the point of putting the economy into recession or even worse. Why, you might ask, is controlling inflation at the risk of jobs, housing prices and falling stock prices so important? The Fed has earned a reputation of being staunch inflation fighters. Under both previous chairmen, Paul Volker and Alan Greenspan, the Fed earned worldwide respect for their inflation fighting efforts. If inflation now gains a foothold, it could take decades to rebuild that reputation.

Inflation or recession that is the age-old conundrum. *Inflated prices last forever, recessions pass on to growth.* The Fed is between the proverbial rock and a hard place. They know that they must raise rates to keep inflation at bay; they also know that doing so will cause the housing sector, from which two fifths of the economy's growth emanates, to experience a drastic slowdown. The chart here shows the “Investech” Housing Index (from James Stacks' Investech Research) and compares housing to the Internet bubble of the past decade. If that chart continues, can the economy avoid recession? Are things different this time?

As you know, patterns in the stock markets repeat over and over again. While “repeat” is a little strong, these patterns quite often “rhyme” and by so doing give us clues to what might lie ahead. The current market is a perfect example of

## Housing Bubble Bellwether Index



Courtesy of Investech Research

history being a good precursor of things to come. You know, from reading prior Navigator Reports (if you didn't they are available on our website [www.ccmg.com](http://www.ccmg.com) under Navigator Reports) that 2006 is the fourth year of a stock market cycle and the second year of the Presidential Election Cycle; both extremely predictable market moving events. For instance, if you average many decades of Presidential Elections you see (according to Ned Davis Research) that the stock market peaks (on average) on April 21st of the second year before beginning the first correction of the year. The peak this year occurred on May 5th for the S&P 500 and May 10th for the Dow Jones, a little late but still within rhyming distance of prior years.

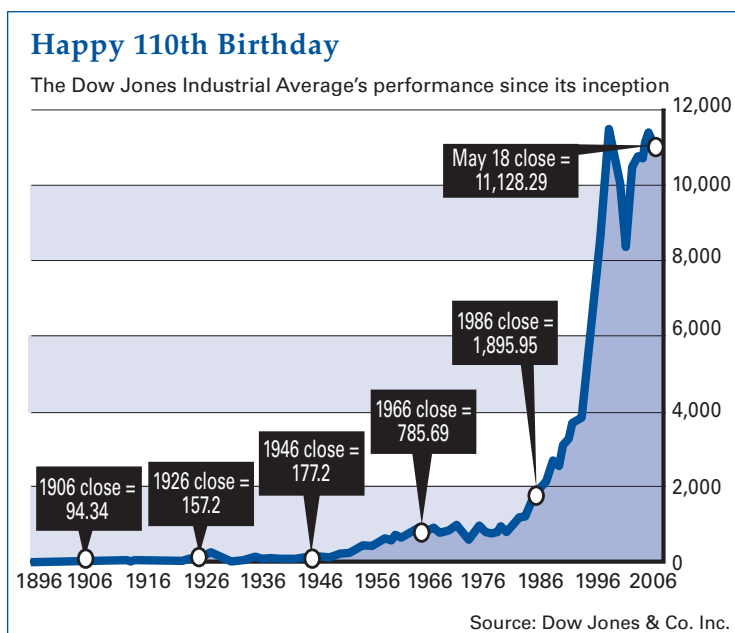
One of the items causing market angst these days is the relentless effort by the Federal Reserve to quell inflation. They have now raised the Federal Funds rate 17 times from 1% to 5.25%. This string of increases is not uncommon: *the Fed has raised interest rates more than three times on 14 prior occasions. Those increases have caused the economy to go into recession 12 times.* But this time is different! All the leading economists are predicting that the economy will remain strong with about a 3-3.5% increase in GDP over the next several quarters. Yes! The Federal Reserve engineered a soft landing twice before, so why not this time? Maybe this time *is* different!

A little known, and not widely published, fact is that when the Discount Rate (the rate that banks pay for money) reaches 6%, as it has seven times since 1920, a bear market has already begun. The one exception was in 1929 when the bear market began three weeks later. The Discount Rate moved to 6% on May 10th of this year. That was the exact day of the current stock market top for the Dow Jones Industrial Average. Has a bear market begun or "is it different this time?"

A "bear" market is defined as a decline of at least 20%. If we were to see a 20% decline from the recent top of 11642.65, it would put us at about 9300 on the Dow Jones. Ned Davis, a very popular and succinct stock market researcher, believes the worst case for any decline this year would be about 24%; well into bear market territory. The chart on the next page was shown in the last Navigator Report. Updated, it is the best guess from Ned Davis Research as to the direction that the market will take this year. It appears that we are a little ahead of things with the current market decline. That is most likely the result of the Middle East situation. Crisis situations do not usually change market direction or disturb existing market cycles but do have the tendency to accelerate tops and bottoms. Could this be happening here?

## HAPPY BIRTHDAY DOW JONES

The Dow Jones Industrial Average celebrated its 110th anniversary on May 26th making it the longest standing index of market action. The Dow reached its all time high of 11,722.98 on January 14, 2000 before declining 38% to the October 2000 bottom. It came within 53 points of the all time high at the current market top on May 10th. So what is this Dow Jones Index?



Courtesy of Investment News

Created by Charles Dow in 1896, it began with 12 stocks and a level of 40.94. It expanded to 20 stocks in 1916 and to the present day number of 30 stocks in 1928. It has remained at 30 stocks ever since but not always the same 30. Stocks have entered and left the index many times over the years as it has struggled to remain representative of the broad market. It is still the most widely quoted, watched, and recognized index in the world. The chart shown here is from Dow Jones Inc. and is reprinted from Investment News, a weekly newspaper for financial advisors.

## WHAT DO WE EXPECT?

So far the market has declined 8% from the May 10th top on the Dow Jones, 7.7% from the May 5th top on the S&P 500, and 14% from the top on the NASDAQ. Some foreign markets, especially emerging markets, have declined considerably more. The expression, "when the U.S. sneezes, the world catches a cold" is still operable.

So what next? First of all I must reiterate that we are very bullish long-term as valuations are coming into areas where the stock market is becoming very attractive. The S&P 500 is trading at 14 times expected 2007 earnings, which is the lowest since 1995. Couple that with history, which shows that over the past 80 years the market has averaged a 51% gain from the low point of the second Presidential year (2006) to the high of the pre-election year (2007). That is one reason that we have been stressing raising cash in our CNBC and Bloomberg debates. **There will be some great opportunities when this market finds its footing later this year.**

Between now and then things could, and I stress could, get a little dicey. You can see from the chart on the last page that the market decline got a little ahead of itself and we are expecting a little rally to get things back on track. Our market allocation systems are telling us that we should rally into the middle of August before the decline potentially resumes.

As discussed before, this is the fourth year of the stock market four-year cycle and the second year of the Presidential Election Cycle. Both call for the decline shown in the chart. The wild card here is the Middle East situation. If Israel succeeds and the area returns to a peaceful standoff, the market bottom anticipated for Oct/Nov could have already been seen. I would not be surprised to see the market rally and then retest before blasting off on the next bull leg. Wouldn't that be different?

Potential investors ask, "Why should I invest now if you are expecting further decline?" In my experience over the past 36 years, people who try to find the exact right moment to enter the market or increase their position, invariably miss out on

the real market bottom. The smarter choice is to invest but hold some reserves if you are expecting a decline. We have been urging investors to raise cash, be comfortable, but not to sell everything. Pruning the portfolio to the point of comfort is just exercising good investment sense. Market bottoms are very hard to catch because when you miss them, you procrastinate to see if the market will come back down again. Not a good investment discipline.

The bottom line could and should be more market decline before a very good rally begins. Take care!

## CCMG IN THE NEWS

June 4, 2006

**CNN Money**

Harry Clark, Chief Executive Officer of Clark Capital



Management, expects the Federal Reserve to raise rates in June and August. Harry points to historical evidence that the Fed typically raises rates higher than what is necessary.

### S&P 500 Index Cycle Composite for 2006

2006 Cycle Composite Places Equal Weight On:  
 One-Year Seasonal Cycle  
 Four-Year Presidential Cycle  
 10-Year Decennial Cycle (Scale Right)

Based On Daily Data 1/3/1928 - 12/31/2005  
**Trend Is More Important Than Level**



Courtesy of Ned Davis Research



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The cited performance data assumes the reinvestment of all dividends and capital gains distributions, and reflects the deduction of the maximum management fee changed by CCMG for the referenced program. Historical performance is available upon request.